

DEPARTMENT OF REVENUE  
STATE OF LOUISIANA



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MANAGEMENT LETTER  
ISSUED MAY 24, 2006

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**LEGISLATIVE AUDITOR  
1600 NORTH THIRD STREET  
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BATON ROUGE, LOUISIANA 70804-9397**

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In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Wayne "Skip" Irwin, Director of Administration, at 225/339-3800.



STEVE J. THERIOT, CPA  
LEGISLATIVE AUDITOR

OFFICE OF  
**LEGISLATIVE AUDITOR**  
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May 12, 2006

**DEPARTMENT OF REVENUE**  
**STATE OF LOUISIANA**  
Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 2005, we considered the Department of Revenue's internal control over financial reporting; we examined evidence supporting certain accounts and balances material to the State of Louisiana's financial statements; and we tested the department's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements as required by *Government Auditing Standards*.

The Annual Fiscal Report of the Department of Revenue is not audited or reviewed by us, and, accordingly, we do not express an opinion on that report. The department's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

In our prior management letter on the Department of Revenue for the year ended June 30, 2004, we reported four findings. The current status of these findings is listed below:

**Resolved by Management**

- Annual Fiscal Report Not Properly Prepared

**Not Resolved by Management**

- Weaknesses in the GenTax System
- Information System Control Weaknesses
- Lack of a Disaster Recovery/Business Continuity Plan

Based on the application of the procedures referred to previously, all significant findings are included in this letter for management's consideration. All findings included in this management letter that are required to be reported by *Government Auditing Standards* will also be included in the State of Louisiana's Single Audit Report for the year ended June 30, 2005.

### **Weaknesses in the GenTax System**

For the third consecutive year, the Department of Revenue does not have sufficient internal control over its tax accounting system (GenTax) functions, which could affect the integrity of processing, financial data, and financial reporting. Good internal control requires that the system has adequate written policies and procedures and adequate written system documentation. For the fiscal year ended June 30, 2005, the department processed in excess of \$6 billion in taxes and other transactions through the GenTax system.

During a review of the GenTax system for the fiscal year ended June 30, 2005, the following control deficiencies were noted:

- The department does not have formal written policies and procedures to control changes made to the GenTax system. These policies and procedures are necessary to ensure that system modifications made by department and third-party information systems personnel are adequately designed, documented, tested, and approved before being placed into production. The department's lack of policies and procedures may result in programming errors in system-generated financial data reports that may result in misstatements in the department's Annual Fiscal Report.
- The department does not have adequate, written documentation in a user-friendly format that clearly explains business requirements, system controls, data flow, system reports, and the results of tests performed during the implementation of the GenTax system. The lack of adequate system documentation limits the ability to independently verify that GenTax is processing tax transactions in accordance with laws and regulations and is producing accurate financial data and reports.

These conditions occurred because the department has not placed sufficient emphasis on documentation and controls over the GenTax system. As a result, there is a risk that GenTax programs and data could be accessed and modified without proper authorization, review, and approval and that errors or fraud could occur and not be detected timely.

Management of the department should establish adequate controls over the GenTax system and processes to ensure that changes to GenTax applications are adequately designed, documented, tested, and approved before being placed into production and that system documentation exists for processing GenTax transactions in accordance with laws and regulations. Management concurred in part with the finding and recommendations and outlined a corrective action plan (see Appendix A, pages 1-3).

### Information System Control Weaknesses

For the second consecutive year, the Department of Revenue has internal control weaknesses relating to access to and monitoring of its information systems (IS). Good internal control ensures that access to hardware, software, and data be limited to the business need of employees; authorized users are assigned individual user identification numbers (IDs); system logs are effectively monitored; and security policies, procedures, and controls are subject to periodic audit.

During a review of the department's IS security for the fiscal year ended June 30, 2005, the following control deficiencies were noted:

- There is an incompatibility of functions because IS programming personnel have access to production software and hardware both at the department and at its offsite operations at the Department of Public Safety. As a result, unauthorized changes to system applications could be placed into production.
- A single user ID for the structured query language server is used for all GenTax database servers and is shared among several database administrators, which could affect the integrity of programs, processing, and data.
- Procedures have not been established for the review of security and system logs to detect security violations and/or inappropriate systems activity.
- The department does not have an effective IS audit function. An adequate system of internal control should include periodic reviews of the IS general and application controls by an IS auditor.

These conditions exist because the department is in the process of restructuring its Information Technology Division. As a result, the risk exists that IS programs and data could be accessed and modified without proper authorization, review, and approval and that errors or fraud could occur and not be detected timely.

Management of the department should establish adequate IS security policies, procedures, and controls and an effective IS audit function to ensure the integrity of programs, processing, and data. In addition, management should evaluate and consider using system monitoring software that would allow the security administrator to effectively monitor system logs and activity. Management concurred with the finding and recommendations and outlined a plan of corrective action (see Appendix A, pages 4-6).

### **Untimely Bank Reconciliations**

The Department of Revenue did not reconcile its bank accounts timely for the fiscal year ended June 30, 2005. Good internal control requires reconciliation of the department's bank account balances to its accounting records and subsequent review and approval by a supervisor on a monthly basis. Bank reconciliations provide management with a basis to ensure that all transactions that affect both the bank accounts and the accounting records are in agreement and that no errors or fraud has occurred.

Our review of the monthly reconciliations for the department's 23 bank accounts disclosed that 49% of the monthly bank statements were reconciled from two to eight months after the department received the bank statements. Management reviewed and approved 25% of the reconciliations from one to three months after they were completed. Furthermore, as of June 30, 2005, discrepancies for eight reconciliations remained unresolved for more than two months. With approximately \$7 billion in revenues deposited during the fiscal year, failure to perform monthly reconciliations increases the risk that errors, misstatements, or fraud could occur and not be detected timely.

Management of the department should establish policies and procedures to ensure that bank accounts are reconciled timely and that reconciliations are approved by an appropriate level of management. Management concurred in part with the finding and recommendations and stated that it has implemented "positive pay" under which "... the risk of errors and fraudulent checks clearing LDR's bank accounts is virtually eliminated" (see Appendix A, pages 7-8).

**Additional Comment:** While we agree that positive pay reduces the risk of errors and fraudulent checks that might clear the bank accounts, it does not reduce the risk of errors and misstatements in the accounting records that remain uncorrected as a result of untimely bank reconciliations, such as errors in manual checks and deposits.

### **Inadequate Controls Over Reporting Claims and Litigation**

The Department of Revenue did not have adequate controls to ensure reasonable and accurate financial reporting of its liability for claims and litigation. Good internal control requires that the department establish procedures to ensure a reasonable estimate of its liabilities for claims and litigation for inclusion in the State of Louisiana's Comprehensive Annual Financial Report (CAFR).

At June 30, 2005, the department reported a liability for claims and litigation of approximately \$80 million. Our review of documentation for 45 of 145 lawsuits disclosed the following:

- Interest calculations for 16 lawsuits (36%) were incorrect.
- Two lawsuits (4%) were reported twice.

- One lawsuit (2%) was reported twice, and the interest calculation was incorrect.
- Partial payments for four lawsuits (9%) were not deducted from the reported liability, and the interest calculations were incorrect.
- Fourteen lawsuits (31%) that had been resolved before June 30, 2005, were included in the reported liability.
- One lawsuit (2%) filed after June 30, 2005, was included in the reported liability.

The above conditions resulted in an overstatement of approximately \$24 million in the department's reported liability. Failure to maintain adequate controls to ensure reasonable and accurate financial reporting of the department's liability for claims and litigation could result in misstatements in the state's CAFR.

Management of the department should establish policies and procedures to ensure accurate reporting of liabilities arising from claims and litigation. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, pages 9-12).

#### **Lack of a Disaster Recovery/Business Continuity Plan**

For the third consecutive year, the Department of Revenue does not have a written, comprehensive disaster recovery/business continuity plan. The state Office of Information Technology Policy Number 11 requires each state agency to develop, test, and maintain a disaster recovery/business continuity plan that is designed to ensure the availability of mission-critical services and functions in the event of a disaster or other event that would impact the agency's information technology (IT) and telecommunications systems.

An adequate disaster recovery plan should include, at a minimum, the following:

- Maintaining a written functional plan that will allow for continued operation of critical IT services in the event of an unexpected interruption
- Routinely backing up data files, computer programs, and documents and storing this information offsite at a remote facility
- Having access to a remote facility that has the same operating systems as the department so that data can be processed and operations can continue with minimal disruption of services
- Training for staff and other users of the system to ensure that they understand their responsibilities in case of emergencies

- Testing the plan to ensure that the plan works as intended

Although the department has taken steps to ensure that its data files and computer programs are backed up and stored at an offsite facility, current policies and procedures do not include a written, comprehensive plan related to disaster recovery/business continuity, the related training and testing to ensure that the plan works as intended, and access to a remote facility with the same operating system. Failure to develop, implement, and test a comprehensive disaster recovery plan increases the risk that in the case of a disaster, there may be excessive delays in collecting taxes owed to the state and in the processing of critical data needed to ensure the accurate collection of taxes.

Management of the department should take the necessary measures to develop and implement a written, comprehensive disaster recovery/business continuity plan to allow critical operations to be reestablished within an acceptable time frame should a disaster or other event occur. Management concurred with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 13-14).

### **Weaknesses in Controls Over Payroll Expenditures**

The Department of Revenue has not maintained adequate internal controls for certification and approval of employee time and attendance. In addition, the department overpaid two employees a total of \$2,257 during the year. Civil Service Rule 15.2 requires classified employees and their supervisors to certify the number of hours of attendance or absence from duty on their time and attendance records. Furthermore, good internal controls require that management maintain adequate controls to approve employee time and attendance before payment.

Our audit disclosed the following:

- During our test of 21 employees' time records, we noted 15 instances (71%) in which a supervisor did not sign the employee's time sheet before entering the time in the payroll system.
- Overpayments were made totaling \$2,257 to two employees, which resulted from the department's administrative errors. These overpayments, which were not recouped by the department, may be a violation of Article 7, Section 14 of the Louisiana Constitution, which prohibits the loan, pledge, or donation to any person anything of value that is the property of the state.

Failure to maintain adequate internal controls, which should include certification and approval of employee time and attendance before payment, may result in errors, overpayments, and fraud. Management of the department should ensure that internal controls for certification and approval of time and attendance are adequate to prevent overpayments to employees and to recoup any overpayments to employees where warranted. Management did not concur with the finding and recommendation and stated that its procedures are in compliance with Civil Service rules. Though the department



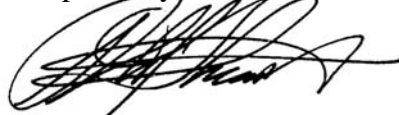
decided not to recoup the overpayments noted, management stated that procedures are in place to reverse or recoup overpayments and correct errors in the leave records subsequent to payroll processing (see Appendix A, pages 15-17).

**Additional Comments:** We agree that Civil Service rules do not require certification and approval of time and attendance before entering time in the payroll system; however, such procedures are an effective means of reducing the risk of errors and fraud or overpayments that the department determines would not be cost effective to recoup.

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the department. The nature of the recommendations, their implementation costs, and their potential impact on the operations of the department should be considered in reaching decisions on courses of action. Findings relating to the department's compliance with applicable laws and regulations should be addressed immediately by management.

This letter is intended for the information and use of the department and its management and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Steve J. Theriot', is written over a horizontal line.

Steve J. Theriot, CPA  
Legislative Auditor

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Management's Corrective Action  
Plan and Response to the  
Findings and Recommendations

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Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

April 19, 2006

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
Office of the Legislative Auditor  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

**RE: Weaknesses in the GenTax System**

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) began its project for an integrated tax system in May 2002. This system's main component is the GenTax software package created by Fast Enterprises, LLC. The customized version of GenTax developed for the twenty (20) largest revenue-producing taxes in Louisiana is called DELTA: "Defining Excellence in Louisiana Tax Administration." This effort represented a major undertaking as LDR upgraded from a mainframe-based Legacy system to a Windows-based software package (GenTax) for tax administration. Equally as overwhelming was this agency's acceptance of the challenge to implement 20 taxes in the span of three years. We are extremely proud to be able to say that the project was completed on schedule and within budget. The final phase of this project was completed in May 2005.

Our positions on the deficiencies denoted in your finding are as follows:

- We concur in part with your statement that the Department does not have formal written policies and procedures to control changes made to the GenTax system. The Department has formal, written *procedures* for change control to the GenTax system in the form of process maps that are included in the supporting documentation. The Department does not yet have a formal written *policy* to address these controls. The projected date to have a formal written policy by the end of fiscal year 04-05 was not met. A prerequisite to developing this policy was the deployment of a new IT Service Request System. This system was not implemented until August 2005. A revised date for a formal written policy is projected to be no later than June 2006.

Through the use of the new "IT Service Request System", the Department has instituted formal procedures for change control within the GenTax system. The IT Service Request System's functions are to ensure that modifications are properly designed, documented, tested, approved, and migrated into the DELTA system. In addition, our continued use of a development environment and a production environment ensures that modifications made by developers follow standardized review and approval procedures prior to being placed into production. Additional benefits of the IT Service Request System include better tracking of requests inventory and better measurement of performance. The functionality of this relatively new system is still being refined and developers are acquiring expertise in its use. Some management reports are still being created. Initial indications are that the system is providing the appropriate change management tools needed and has improved the change control process.

- We concur in part with your finding that "the department does not have adequate, written documentation in a user-friendly format . . ." However, management has recognized the need for comprehensive documentation of the system. In response to this need, an extensive amount of material has been identified, created, and assimilated. Provided in the supporting documentation is a Table of Contents, which represents the "Technical System Documentation" portion of this information. In addition, an internal tool has been developed to better analyze and report on GenTax components, which will aid in creating this documentation. More work is needed in the area of improving the presentation of this data into a more easily accessible and clearer format. For example, much of the business rules are contained in meetings documentation; but is not in a readily accessible format. Some data flows are embedded in presentation documents. This information will be re-formatted. Identifying and addressing "gaps" in the information is also continuing as is implementing a process to keep the material up to date.

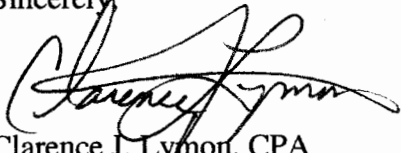
Though I agree with your general concern as it relates to the inadequacy and lack of a user-friendly format for the documentation as a whole, exception is taken to your statement that: "The lack of adequate system documentation limits the ability to independently verify that GenTax is processing tax transactions in accordance with the laws and regulations and producing accurate financial data and reports." I respectfully submit that a lack of comprehensive and user-friendly documentation may have resulted in a change in auditing procedures utilized to verify the effectiveness of the tax processing system. However, I disagree that this documentation limited your ability to verify whether the system is processing tax transactions in accordance with the laws and regulations and producing accurate financial data and reports. The deficiencies noted and agreed upon certainly impeded the auditors' ability to perform streamlined and efficient auditing procedures, however, the ability to verify the accuracy of financial data and reports was (and is) not compromised.

Mr. Steve J. Theriot  
April 19, 2006  
Page 3

The IT Division at LDR shares your staff's concern and desire for a more user friendly format for system documentation and we are committing the resources necessary to ensure that we achieve this objective. As mentioned above, we believe that procedures in place during the implementation phases of the system were sufficient to timely prevent and detect errors or fraud.

LDR's management is committed to ensuring that appropriate procedures are established and adhered to in order to discourage, detect, reduce and eliminate fraud. This is and will always be a top priority for our agency.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Lymon", written over a horizontal line.

Clarence J. Lymon, CPA  
Undersecretary

c: Cynthia Bridges  
Greg Montagnino  
Phyllis Perry



Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

March 31, 2006

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
Office of the Legislative Auditor  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

**RE: Information System Security Weaknesses**

Dear Mr. Theriot:

The Louisiana Department of Revenue concurs with your finding that there exist internal control weaknesses relating to access to and monitoring of information systems. However our current procedures for allowing access to data, hardware and software are restricted based upon the business needs of the employees. The agency allows access to system administrator functions to only minimal staff and physical access to production software and hardware is restricted. Current policies, procedures and controls are subject to continual review and improvement.

Action is either planned or being taken in all areas identified in your finding. Below are our responses to the specific issues denoted in your report:

- Reorganization has enabled the Information Technology Division (IT) to better use its resources and provide an adequate level of separation of duties. In addition, sensitive equipment has been confined to locked cages. With the IT reorganization, responsibility for changes to the electronic filing server has been transitioned to the production control staff to accomplish a separation of duties. Access by E-services personnel will then be restricted to only the applications changes that are needed each year. A policy (PPM 90.7) to formally outline access restrictions has been drafted and is actively being revised/reviewed by IT and the Policy Services Division. The target date for resolution of this finding is June 2006; however, recent progress indicates it could be done sooner, perhaps as early as mid-April 2006.



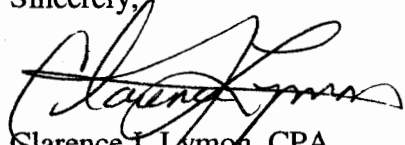
- Current procedures still allow for the use of a single password by two (2) administrators for SQLServer on the database servers. The IT Division is studying the problem and has identified a tentative solution to be implemented once testing is complete and they are assured there will be no undesirable consequences. Until that time, limiting the number of employees with this access and with periodic review of log entries by the team lead has mitigated risk. A final resolution should be in place no later than June 30, 2006.
- Formal procedures have not been established for the review of security and systems logs. However, this finding can be resolved with (1) software to log, alert and report suspicious incidences, (2) personnel in place to monitor the logs and follow up with appropriate corrective actions, and finally (3) formal written procedures. As of November 2005, management software - Microsoft Operations Manager (MOM) – was installed to allow for better logging and immediate alerts to certain access exceptions. A timeline for establishing formal procedures will be generated once the capabilities of the software are more thoroughly understood and tested. Additional software purchases were planned for fiscal year 2006/2007 such as Identity Management, Risk Management, Access Management, Compliance Management and Desktop Security Agent. However, budget constraints created by Hurricanes Katrina and Rita has put the acquisition of these tools in jeopardy. The new IT organizational structure calls for an additional staff member in the IT Security Section, which will allow for additional monitoring and product deployment and utilization
- As previously explained, during fiscal year 2005, LDR and Internal Audit (IA) hosted an IRS Safeguard Review, which is conducted every three years. This audit and subsequent Internal Audit follow-up focused not only on IT general controls, but on controls over information security and taxpayer privacy and confidentiality as well. Also during fiscal year 2005, IA hired an Assistant Director with IS audit experience and certification and reorganized to include two auditor supervisors, one of whom (also CISA certified) will specialize in Information Systems Audit, along with two dedicated staff auditors. Given these resources, IA will be implementing an IS risk assessment methodology and including an IS audit program as part of its annual audit planning process for FY 06 and beyond. In fact, an initial proposed IT audit plan and draft IT audit risk assessment have been created. The IT audit schedule proposed involves a broad list of IT areas to be addressed over the next two to three fiscal years, including application change management and controls in DELTA and other applications. The staff is already compiling updated IT infrastructure and general controls information to evaluate and plan future audit areas.

LDR management is committed to establishing adequate IT security policies, procedures and controls as well as an effective IT audit function. We believe that the actions planned or currently underway will further strengthen this area. As is customary, consideration will also be given to the findings' specific recommendations during this continuous improvement process.

Mr. Steve J. Theriot  
March 31, 2006  
Page 3

The individuals responsible for corrective action are Greg Montagnino, Information Technology Division Director, and Phyllis Perry, Internal Audit Division Director.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Lymon". The signature is stylized with a large, sweeping initial "C" and a long, horizontal flourish extending to the right.

Clarence J. Lymon, CPA  
Undersecretary

c: Cynthia Bridges  
Greg Montagnino  
Phyllis Perry



Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

March 31, 2006

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**RE: Untimely Bank Reconciliations**

Dear Mr. Theriot:

The Louisiana Department of Revenue concurs in part with your finding. We agree that ideally the bank accounts should be reconciled and approved on a monthly basis; however, LDR had to utilize its bank accounting personnel to help coordinate the conversion of our Legacy bank accounting system to the new GenTax bank accounting system during fiscal year 2005. The utilization of these employees precluded them from completing the monthly bank reconciliations timely. It should be noted that all bank reconciliations for the fiscal year end June 30, 2005, were accurately completed and approved before the fiscal year end close of August 14, 2005.

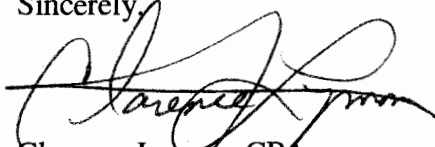
We do not agree with part of the finding that states errors and fraud could occur and not be detected timely if bank reconciliations are not completed monthly. As part of the conversion to the GenTax bank accounting system, LDR implemented "positive pay". Under "positive pay", the risk of errors and fraudulent checks clearing LDR's bank accounts is virtually eliminated.

Mr. Steve J. Theriot  
March 31, 2006  
Page 2

Corrective Action Planned

Additional professional accounting staff will be used to assist in reconciling the bank accounts on a timelier basis. The persons responsible for such corrective action are Joyce Anderson, Controller, and Cynthia Daneshmand, Accountant 3, of the Controller Division.

Sincerely,



Clarence Lyman, CPA  
Undersecretary

c: Cynthia Bridges  
Dale LeJeune  
Joyce Anderson



Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

April 19, 2006

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
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**RE: Inadequate Controls over Reporting Claims and Litigation**

Dear Mr. Theriot:

We concur with your finding that the LDR did not have adequate controls to ensure accurate financial reporting of its liability for claims and litigation. As is relates to the compilation of the report for the Office of the Attorney General (AG), FYE June 2005 was a unique year. A major challenge encountered by the Legal Division was phasing out the Legacy computer system that was replaced by a new integrated tax system (GenTax). In addition, during this same period, our Legal Division attempted to use an older product for tracking and case management purposes. Basically, the fiscal year ended without a comprehensive and reliable case tracking and management system for the Legal Division. Consequently, the FYE June 2005 report was prepared based on information kept on Excel spreadsheets internal to the Legal Division, based on the old Legacy computer system reports.

The 2005 AG's report was initially prepared by simply updating the information from the 2004 AG's report, i.e., by removing the cases that were closed since June 30, 2004, and by adding the new cases opened during the period. The 2004 AG's report had **not** been the subject of a "finding" in the previous year's audit, and therefore it was assumed that the 2004 starting point for the preparation of the 2005 report was an accurate beginning. The legal staff took the position that the only serious detail work that would be required would be on the cases opened during FYE June 2005. However, your auditors' review of the AG's report revealed that lawsuits that were resolved prior to FYE June 2005 represented over ninety percent (90%) of the \$24 million overstatement in the reported liability. This was due to the fact that our Legal Division failed to accurately track cases that should have been

removed from their manually prepared spreadsheets. In addition, several claims should have been reduced as a result of actions taken by the Department and/or the taxpayer. This is being remedied, primarily by a reduction in caseload per attorney and more collaboration with the client divisions with respect to the disposition of cases in litigation.

During the years that led up to this 2005 finding, i.e., the fiscal years 2000 through 2003, inclusive, the Legal Division had approximately 2,200 cases or 169 plus cases per lawyer. (The SEATA average is 25 to 40 cases per lawyer). A large caseload leads to less time per case and less time to perform administrative and clerical tasks such as reconciling refund balances with client divisions and preparing reports. The solution to this problem has been to reduce the Division's case total from 2,200 in 2002, to less than 1,200 in 2006, by using mediation, arbitration, and settlement. It is felt that this more realistic, though still burdensome, caseload of 92 cases per lawyer will lend itself to allowing for the performance of the administrative detail work necessary to the preparation of an accurate AG's report for the future.

As mentioned above, the inability to accurately track cases in progress as well as changes in claim amounts contributed to an overwhelming majority of the overstated liability. Below are our responses to the specific issues denoted in your finding:

- **Interest calculations for 16 lawsuits were incorrect** – According to the work papers provided by your auditor, interest calculations for sixteen (16) lawsuits (or 36%) were adjusted for reasonableness. We believe that our interest calculations were correct, although we agree that a more reasonable estimate may be appropriate in some of the cases in question. Basically, the interest adjustment amounted to approximately nine percent (9%) of the proposed audit adjustment.
- **Two lawsuits were reported twice** - We agree that two administrative claims were reported twice. The problem of duplication usually comes from classification of cases between appeals of refund denials on the one hand, and claims against the state, on the other. Many tax attorneys plead both causes of action in one petition. Some attorneys file two separate petitions. It is difficult to determine when an attorney pleads one, or the other or both, since the pleading must be given a reading most favorable to the taxpayer. Occasionally, reasonable minds differ and where one attorney might see a claim against the state, another attorney would consider the petition to be the appeal of a refund denial. When two separate petitions are filed, and assigned to different attorneys, it has been difficult in the past to determine that there is only one claim. Especially when the cases are allowed to languish and the taxpayers do not assert their right to move the case forward.
- **One lawsuit was reported twice and the interest calculation was incorrect** – We agree that the lawsuit in this case was reported twice and the interest reported was incorrect. The issue of double reporting certain claims is discussed above.

- **Partial payments not deducted** – We agree that in some cases, notice of partial payments was not given to the attorney by the client division. In others, there was a misunderstanding by the attorney as to the correct procedure. In the past, attorneys have not been required to reduce the carrying value of claims on their inventory because of partial payments. The legal file is not updated with this information. The partial payments were merely brought to the attention of the Board of Tax Appeals by the auditor at the time of the hearing. This is simply a procedure that needed to be modified and has been corrected.
- **14 resolved lawsuits cases included in reported liability** – The General Counsel of the Legal Division concurs; however, we have been unable to specifically identify all fourteen cases that were mentioned in the finding. There are two issues worth mentioning about this process. First, the Legal Division is not permitted to remove cases from its inventory until closed. The closing process takes from two weeks to one month. Secondly, an inordinate amount of cases had been mediated, arbitrated or settled immediately prior to the close of fiscal 2005. Not every case was processed within the expected time frame. Therefore, timing issues are inherent in the process.
- **One lawsuit filed subsequent to 6/30/05 was included** – We agree with this statement and attribute this to human error.

The first and most important step in our corrective action plan is that the Department has ordered a state-of-the-art case management system (Pro Law by Thompson, owners of Westlaw) that once implemented, should make reports such as the AG's report a routine exercise in report printing. The Pro Law system automatically computes interest updates.

Meanwhile, using the information available, the Legal Division has already started on the 6/30/06 AG Report in hopes that the July/August crunch will be avoided and will allow more time for accurate preparation and computation. A uniform Excel spreadsheet has been prepared for each attorney, which, in addition to case name and number identification, sets forth the total claim (to be verified by the client division for refunds or other adjustments made subsequent to the opening of the legal file), the total claim period, the middle-month of the period, and the total number of months in the period. Interest is to be projected using the following method: (a) if the claim is for one tax period only, interest is computed for the entire period beginning with the date provided by RS 47:1604 and ending on 6/30/06; (b) if the claim includes multiple tax periods, but is less than \$5,000.00, interest is computed from the due date of the first period through 6/30/06 on the full claim amount; (c) if the claim includes multiple tax periods, but is more than \$5,000.00, interest is computed based on the full claim amount for all periods using the period from the middle-month (or middle-year) to 6/30/06 as the interest period. Total tax and total projected interest using one of the above methods will be set forth on the spreadsheet.

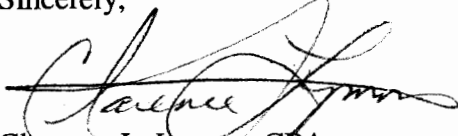
Continuing, the last three columns of the uniform Excel spreadsheet contain the ABA/AICPA-approved columns for legal estimation, i.e., **remote**, **reasonably possible**, and **probable**. Totals claim amounts from the totals column will be extended to one or more of

Mr. Steve J. Theriot  
April 19, 2006  
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these final three columns as evaluated by the attorney of record. It is suspected that, pursuant to the guidelines of the ABA Statement of Policy, there will be few if any claims classified as remote. It is further anticipated that most claims will fall into the category of reasonably possible. Those that are probable will necessarily be included in both reasonably possible and probable. In this fashion, management expects to receive a preliminary report in mid to late May for internal inspection and verification. It is hoped that this manual method will hold the Division in good stead until the new Pro Law system can be installed and tested. The anticipated completion date is April 30 2006.

The person responsible for corrective action is Alva "Ace" Smith, General Counsel of the Legal Division.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Lymon", written over a horizontal line.

Clarence J. Lymon, CPA  
Undersecretary

c: Cynthia Bridges  
Greg Montagnino  
Phyllis Perry





Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

March 31, 2006

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
Office of the Legislative Auditor  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

**RE: Lack of a Disaster Recovery/Business Continuity Plan**

Dear Mr. Theriot:

The Louisiana Department of Revenue recognizes and concurs with the need for an agency Disaster Recovery/Business Continuity Plan.

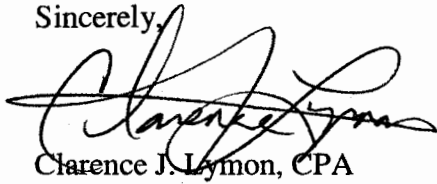
The Department received funding for this initiative in fiscal year 2004-05, and a Request for Proposals was issued the first quarter of calendar year 2005. LBL Technology Partners was the selected vendor. Work began in September 2005. The project is in progress with a projected completion date no later than June 2006. The results of this effort will comply with the State's Office of Information Technology Policy No. 11, and uses the recommended software methodology. We are certain that the minimum requirements enumerated in the audit finding will be fulfilled with this effort. Ongoing activities subsequent to the plan's completion will include regular review, update, and testing of the plan's viability.

In addition, the agency submitted a Continuity of Operations Plan in conjunction with the State's Office of Homeland Security and Emergency Preparedness in March 2005. While not specifically an information technology (IT) plan, this effort incorporated IT functions as they relate to the agency's overall business functions.

Mr. Steve J. Theriot  
March 31, 2006  
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The contact person for this initiative is Greg Montagnino, Information Technology Division Director.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Laymon". The signature is stylized with a large, sweeping initial "C" and a long, horizontal flourish extending to the right.

Clarence J. Laymon, CPA  
Undersecretary

c: Cynthia Bridges  
Gary Matherne  
Greg Montagnino  
Phyllis Perry  
James Greeson



Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

April 19, 2006

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
Office of the Legislative Auditor  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

**RE: Weaknesses in Controls Over Payroll Expenditures**

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) does not concur with your finding that the Department has not maintained adequate internal controls for the certification and approval of employee time and attendance. It is our position that our procedures for certifying payroll documents are in compliance with Civil Service Rule 15.2.

Below are our responses to the specific issues of concern identified in your finding:

- **Failure to obtain supervisory approval prior to entering payroll data –** Foremost, Civil Service Rule 15.2 does not require and/or mandate that a supervisor must sign the employee's timesheet prior to entry of the time in the payroll system. In fact, Civil Service Rule 15.2 requires the appointing authority and each employee to certify service rendered, number of hours of attendance on duty and number of hours of absence from duty. There is no mention of the timing in which this is to occur. However, we understand the necessity and rationale for ensuring that the certification takes place within a reasonable time period after the end of a payroll cycle. LDR's own rules require that the supervisor and director of each division certify the data required per CSR 15.2 in addition to the appointing authority (or his designee). Although we agree that the data is sometimes keyed to the payroll system prior to receiving all the required signatures, the signatures of the employee, supervisor and director are secured

prior to payment being made. It is virtually impossible to secure all of the required signatures prior to keying and payment due to logistical reasons. However, it is our position that the procedures in place before and after payroll has been processed are in compliance with Civil Service Rules. Of particular importance in this debate is the fact that there exist methods to correct errors discovered after payroll entry. If an overpayment is discovered prior to the payment being made, the agency can process a reversal of the payment in ISIS or the employee can be notified of the overpayment (in accordance with the Recoupment of Overpayments Policy) and the overpayment is then recouped from subsequent checks. If an underpayment occurs, off-cycle checks can be processed to correct the payment. Errors in leave records discovered after the payroll cutoff are corrected through the Prior Period Adjustment process. We do not believe that any adjustments to our current procedures are warranted with respect to payroll certification.

- **Overpayments to two employees as a result of administrative errors** – The overpayments in question were caused by errors made by the Payroll Administrator. In both overpayment situations, the employees were in detailed positions prior to leaving state service. Our Payroll Administrator was unaware of the proper procedures for computing separation pay in this particular scenario. However, there was no intent on behalf of anyone in this agency to violate Article 7, Section 14 of the Louisiana Constitution. In both cases, a business decision was made to forego recoupment of the funds after the LDR Legal Division advised that it would not be cost effective to pursue recoupment through the legal process. In addition, a review of our records will demonstrate that we take a very aggressive stance on the recoupment of overpayments. The Human Resources Division has held training on this issue for the division employees and has updated the payroll unit's process maps to ensure that this error does not happen in the future.

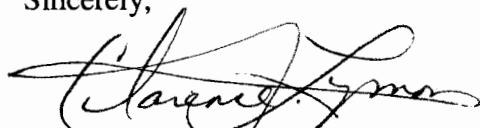
We believe that sufficient controls are in place to maintain the integrity of the payroll records and that controls are sufficient to ensure compliance with Civil Service Rules. In order to eliminate the possibility of payroll fraud, our procedure is to run payroll reports after the point when data for a specific period can no longer be entered. LDR timekeepers are required to reconcile the final reports from the system to the original entry timesheets. Our procedure requiring certification of payrolls by the employees, their supervisors and the appointing authority is in compliance with CSR 15.2.

Again, it is our position that the procedures in place are adequate protection from errors, overpayments, and fraud. Also internal policies and procedures exist to prevent overpayments and to recoup any overpayments when errors occur.

Mr. Steve J. Theriot  
April 19, 2006  
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The contact person responsible for corrective action and quality review is Dee Everett,  
Director of the Human Resources Division.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Lymon". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Clarence J. Lymon, CPA  
Undersecretary

c: Cynthia Bridges  
Dee Everett  
Phyllis Perry